



THE ASSISTANT SECRETARY OF THE NAVY
Research Development and Acquisition
1000 Navy Pentagon
Washington DC 20350-1000

APR 14 1998

MEMORANDUM FOR DISTRIBUTION

Subj: COMMERCIAL ITEM PRICING

Ref: (a) OASN(RD&A)ABM memo of 11 Jun 1997

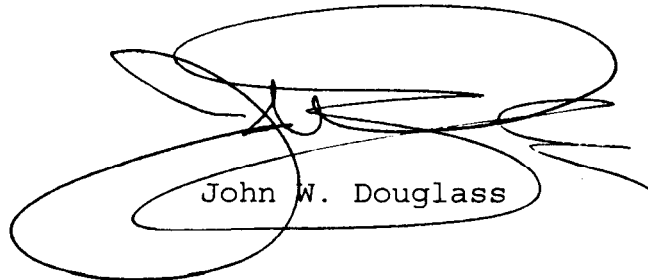
Encl: (1) Pricing Factors to Consider in Market Research

Recent DODIG audits have disclosed examples of DoD activities buying commercial items, frequently spare parts, at prices which are much higher than prices paid previously, or which are higher than reasonable observers would expect to pay.

With our shift to increased use of commercial items, and the streamlined acquisition procedures now available, come increased scrutiny of our buying practices. The advantages provided by these streamlined procedures bring some additional responsibilities and risks. In past sole source acquisitions, we frequently came to rely on cost-based pricing to determine fair and reasonable prices. In the commercial markets in which we are operating today, price-based contracting is the norm.

Price-based contracting puts a greater emphasis than ever on market research, and requires the acquisition team to fully understand the dynamics and motivating forces at work in the marketplace. In every situation, we have to ensure that the prices we pay are fair and reasonable, and as noted in reference (a), the existence of a commercial catalog price for an item does not mean either that the catalog price is reasonable, nor does it mean that the item is necessarily a commercial item. The acquisition team needs to look beyond catalog prices to understand the bigger picture. Enclosure (1) identifies some of the factors to consider.

Please make sure all members of your acquisition teams maintain a high level of awareness of the importance of these issues, as well as the importance of documenting and being able to explain the merits of their decisions.


John W. Douglass

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PRICING FACTORS TO CONSIDER IN MARKET RESEARCH	
1. Pricing history	What information is available concerning past prices paid for the product and changes in the product or market?
2. Competitive conditions	How many sellers are in the market? How many buyers?
3. Overall level of demand	What is the relationship of the quantity we intend to buy vis-a-vis the quantities that others buy? Will our volume justify a lower than market price due to the seller's increased economies of scale? Will our volume be so large as to drive the sellers to or beyond full capacity, resulting in unanticipated inflation?
4. Trends in supply and demand	Will demand be higher or lower at the time of award than now? Will supply capacity keep pace with demand?
5. Pattern of demand	Is there a cyclical pattern to supply and demand? Would awarding six months from now result in lower prices than an immediate award? Or would it be better to stock up now at today's prices?
6. Other market forces that can affect contract price	What forces might drive up prices in the near future? Strikes? Labor shortages? Subcontractor bottlenecks? Energy shortages? Other raw material shortages? What forces might lead us to expect lower prices in the future?
7. Pricing strategies	What are the pricing strategies of firms in the market? What are the implications for expected prices?
8. Sources of supplies or services product characteristics	What features distinguish one product from another? Which commercial products match most closely with the Government requirements document (as it currently reads in the purchase request). What is the apparent tradeoff between features and price?

Enclosure (1)

9. Delivery/performance terms	What are the current distribution channels? What are current transportation costs (if available and applicable)? What are the commercial lead-times?
10. Ownership costs	What are the commercial warranty terms and conditions (if any)? What are the historical repair costs for each product? What are the historical maintenance costs for each product?
11. Contract terms and conditions	What terms and conditions are used in commercial transactions? What terms and conditions have been used in other Government acquisitions? What type of contract is generally used in commercial transactions? Government acquisitions?
12. Problems	What has been the historical default rate by firms performing similar contracts? What performance problems have typically been encountered? Have similar acquisitions been characterized by claims or cost over-runs?

Enclosure (1)